"CEAT Limited

Q2 FY '24 Earnings Conference Call"

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MODERATOR: **MR. MITUL SHAH – DAM CAPITAL**

Moderator: Ladies and gentlemen, good day, and welcome to the CEAT Limited Q2 FY '24 Earnings Conference Call hosted by DAM Capital. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mitul Shah from DAM Capital. Thank you, and over to you, sir.

Mitul Shah: Yes, thanks, Rayo. Good afternoon, good evening, good morning to all the participants. On behalf of DAM Capital, I welcome you all for CEAT's Q2 FY '24 Post Results Conference Call. Thank you, CEAT, for giving us the opportunity to host the call. We have with us CEAT management represented by Mr. Arnab Banerjee, MD, and CEO; and Mr. Kumar Subbiah, CFO. Without wasting any time, we'll invite Mr. Arnab Banerjee for his initial remarks. Over to you, sir.

Arnab Banerjee: Thank you. Good afternoon, and welcome to CEAT's quarter 2 FY '24 earnings call. I'll be taking you through the business updates for the quarter and then hand over the call to Kumar Subbiah for his remarks on financial performance. Post that, we'll be open for Q&A.

So let me start with the big news of CEAT winning the Deming Grand Award. As you are aware, this is one of the most prestigious quality awards presented by the union of Japanese scientists and engineers called JUSE, for excellence in total quality management. CEAT became one of the only 33 companies in the world and the only tyre company in the world to win this honour since its inception in 1969. This award points towards consistency of customer experience across the globe and consistency in market share gains and financial performance.

I'll come to the performance proper for Q2. As the base is now normalized, we are reverting to more commonly referred year-on-year comparison for volume.

Quarter 2 was a good quarter for us with an overall volume growth of 7% over last year's quarter 2. Exports are doing good and grew about 10% over the same period. Passenger car tyres had a significant uptick, followed by truck and bus tyres. Off-highway volumes were a little subdued due to a slowdown in Europe. Replacement volumes grew about 4% year-on-year. Domestic off-highway grew very well with a strong double-digit growth, followed by passenger car tyre. Two-wheeler and truck/bus tyres volume also grew in low single digits. OEM business continued to witness healthy momentum with volumes growing by about 10% over last year. Truck and bus volumes grew by more than 35% as a testimony to increasing acceptance of our truck/bus radial tyres quality-wise. Two-three-wheeler sales have also done well, indicating a gradual recovery towards the end of last quarter.

Over Q1 FY '24, volumes grew about 3.5%. And despite quarter 2 being seasonally a low quarter. Replacement was flattish, while OEM registered double-digit growth in anticipation of festival sales. Exports saw a marginal drop.

Demand outlook, as you know, monsoon overall has been good, but the special distribution and the timing were inconsistent. This is likely to affect the Kharif crop output in some states and could also adversely impact the nascent rural recovery. So we would wait and watch the situation closely. As of now, replacement demand is stable across all categories with routine seasonal trends.

On the OEM side, vehicle sales growth has been varied across category. Two-wheeler bikes, de-grew in quarter 2. Four-wheelers are doing well, which topped 2 million cars in half 1, and truck and bus are growing in single digit in quarter 2.

Export markets are improving, especially the markets around Asia and Africa. Europe is impacted by recessionary trends. And as I said, traditional geographies for us like Middle East, Africa and SAARC are normalizing.

On margins, input prices remained benign during the quarter, the raw material basket market declined by about 2.5% to 3% vis-a-vis quarter 1. We have largely been able to maintain our selling price Q-on-Q. And there was also a relative price positioning change in aftermarket in some categories. Both these factors along with better product mix, contributed towards gross margin expansion over 200 bps quarter-on-quarter and stand-alone margin -- EBITDA margin for the quarter stands at 15% and net profit stand-alone was INR199 crores.

Capacity utilization has been improving consistently and is about 80% overall. Better margins and higher utilizations have helped improve our ROCE as well. And we will continue to focus on ROCE by improving capital productivity and efficiency.

On the margin outlook, crude prices, as you are aware, has been going up steadily. If the current prices sustain, RM basket may be going up 3% to 4% over quarter 2 base, I think we have bottomed out on RM prices. We are watching the situation closely and will take action as appropriate going forward.

CEAT is future ready. We are looking at all the megatrends with focus, like electrification going global, premiumization and digital.

As far as electrification is concerned, we continue our strong market share in OEMs in electric vehicle 2-wheeler tyres with more than 40% share of business. Recently, Oben electric e-bike, e-Sprinto, MR EV scooters were launched on CEAT tyres. In passenger market also, we are working with OEMs with several models launched or to be launched such as Mahindra XUV400, MG Comet, ZS electric vehicle, Citroen c3 and some upcoming launches like BYD Auto, Tata Punch EV, KIA couple of vehicles, Pravaig and EVA.

In commercial segment, electric vehicles such as Tata Motors, Ace Electric, Mini Pickup as well as electric buses by Tata Motors, we are participating also with OEMs like Volvo, Eicher Olectra,

I would like to continue on our international business pursuit. We have a run rate of selling more than 2 million passenger car tyres internationally with nearly half of them going to Europe.

This business is doing well.

We are the largest imported tyre brand in Brazil in the off-highway segment. We have also got into several flagship OEMs such as John Deere, CNH, AGCO in off-highway retires, and we have added 40-plus SKUs in this vertical in quarter 2.

Truck/bus radial tyres are doing well in Europe and Latin American markets. We are getting ready for U.S. rollout by end of current financial year for both Truck/bus radial and passenger car radial. That program is going on schedule. About 200-plus SKUs will be launched across these two categories in the U.S. Sri Lanka macro situation is improving and quarter 2 has been a good quarter, both top line-wise and margin-wise in Sri Lanka.

The third major initiative is premiumization with launch of platforms such as Crossdrive, SportDrive, SecuraDrive and SecuraDrive SUV, the passenger car radial portfolio is getting premiumized, and the revenue share from these new platforms, the revenue saliency continues to improve.

CEAT has started investing in a new brand property called CEAT Trails which is about expedition. The first one happened over 22,000 kilometres from Mumbai to Siberia. This convoy went on CEAT CrossDrive and CEAT winter tyres and it was -- the entire expedition went through India, Nepal, China, Mongolia, and Russia, and it was completed successfully.

We continue to strengthen our association with cricket. The 25th addition of CEAT Cricket rating and awards were held in Mumbai in this quarter. We are proud to share that we have onboarded Shafali Verma as our brand ambassador during this quarter. And with the world -- onset of World Cup, we've launched season 2 of CEAT Timeout Series with Matthew Hayden.

As a love of riding increases across the country, CEAT is expanding its portfolio and introducing new product platforms for rally, dirt biking as well as in upmarket steel radials.

Digitalization is the third major trend where CEAT continues to remain a leader. We are implementing Industry 4.0 practices across our plants. The Chennai plant went through the assessment of Lighthouse factory in quarter 2. We are awaiting the results of the assessment. As far as end consumers are concerned, we are heavily invested in marketing CRM. We received 1.5x more searches on SUV tyres, 7.5x higher brand mentions and 12x higher interactions per month so far this year vis-a-vis FY '23. We are generating about 6% of our passenger car replacement sales from B2C channels.

Capex. Our overall capex for the year is likely to be about INR800 crores. Previously, we had mentioned INR750 crores. All expansion projects are progressing as per plans. And we want to reiterate our strategy of doing bite-sized capex every year. This will help us maintain consistency in margins as well as the return ratios.

Sustainability is an important pillar for us. We continue to reduce carbon footprint. For the half year our ton carbon emissions per metric ton of production was lower by 16% Y-o-Y. About 36% of our plant power requirement is through renewable sources and we intend to increase this contribution further during FY '24. Water consumption per ton of production in half 1 reduced 8% Y-o-Y. Natural rubber was sourced by an alternate source to the extent of 25%.

Leading our purpose on safe mobility, CEAT has also created kiosks, provided free tyre service on the new Samruddhi Highway, nearly 100 cars avail this service every day. This initiative was taken as the accidents on Samruddhi Highway were increasing with tyre burst cited as the major cause.

So the benign raw material situation has helped us take faster strides towards making CEAT brands stronger as well as improving our return ratios. As demand remains buoyant, we are hopeful of managing the volatility in raw material basket in coming quarters. As a Deming Grand winner company, we want to become more and more consistent in our financial performance, despite the inherent nature of our raw materials and are working on several controllables, which help us navigate this better.

With this, I would like to hand over the call to Kumar for his remarks.

Kumar Subbiah: Thank you, Arnab. Good afternoon, ladies, and gentlemen, and thank you for joining our call pertaining to quarter 2. I would like to share some further financial data points with you all, post which we can enter into Q&A session.

First, revenue. Our consolidated revenue for the quarter stood at INR3,053 crores, showing a quarter-on-quarter growth of 4% and year-on-year growth of 5.5%, largely both driven by volumes. As Arnab mentioned, our revenue crossed an important milestone of INR3,000 crores during the quarter for the first time.

Coming to gross margins, our gross margin for the quarter moved up from 41.1% to a healthy 43.3%, largely driven by lower raw material costs and better product mix. And the raw material costs were lower in quarter 2 to the extent of about 2.5% versus quarter 1.

And the better product mix helped further in improving the gross margin and which to the tune of good overall 227 basis points. Crude oil, which was hovering around $75 to $80 range in quarter 1 has been slowly now largely operating at the higher end of around $90 to $95 since middle of August. And the same has impacted the prices of feedstocks that go into making of tyres.

In general, as you are aware that any increase in crude oil prices have always had inflationary impact not only on crude derivatives, but also on many other commodities in general. International rubber prices have moved up by about $100 in the last two months. Taking further into consideration the depreciation of Indian rupee in the last three months, we expect our raw material basket to increase by about 4% in quarter 3 versus quarter 2.

As Arnab mentioned, we'll continue to remain watchful of the overall situation and take corrective actions wherever possible. Coming to debt, capex and working capital. We spent about INR170 crores of capital expenditure during the quarter. And with this, our overall capital expenditure in the first half is about INR390 crores. We expect our full year capex to be around INR800 crores, marginally higher than our earlier estimate of about INR750 crores.

Working capital has remained at similar level, which is about negative INR140 crores as we saw it in the previous 2 quarters. We generated healthy operating and free cash flow during the quarter and the cash that we generated, we used it to fund our entire capital -- capex requirement fully and also to reduce our debt.

Our consolidated debt stood at INR1,890 crores, a reduction of about INR103 crores over quarter 1 of current financial year. Coming to leverage ratios, our debt to EBITDA now stands at healthy level of under 1.2x and debt equity to the tune of about 0.5x.

And during the quarter, the annual credit rating review happened and our credit rating of AA for long-term and A1+ for short term was affirmed by India Ratings. Coming to operational expenses. Employee costs increased by approximately 11% quarter-on-quarter, largely on account of annual increment cycle effective July and also a higher level of production activities in factories during the quarter vis-a-vis the previous quarter.

Other expenses also moved up by about 4%, largely in line with increase in our volumes. As regard to Sri Lanka business, we are happy to inform you that our volumes have now started growing in line with the improvement in economic conditions in Sri Lanka, leading to improvement in the profitability of the business also during the quarter.

Overall, our consolidated EBITDA for the quarter stood at INR463 crores which translates to a margin of about 15.1%, almost 200 basis points higher than quarter 1 and almost double that of the same quarter of last year. Our stand-alone EBITDA of 15% is the highest in the last 6 years.

Our consolidated profit after tax stood at INR207.76 crores, which compares favourably with the PAT, profit after tax of INR6.44 crores the same quarter of last year and INR144 crores in quarter 1 of the current financial year.

During the quarter, the company made an investment of approximately about INR20 crores in entity called, TyresNmore, through both primary and secondary group. With this investment, TyresNmore now has become a fully owned subsidiary of CEAT.

And depreciation and interest costs in quarter 2 is largely similar to quarter 1. Effective interest rate has increased by about 5 basis points over quarter 1, we expect interest rates to remain similar or slightly higher levels in the near term.

During the quarter, the company also paid 120% of dividend translating to approximately about INR49 crores as approved by shareholders during the Annual General Meeting in July 2023.

With this, now we can now open the floor for Q&A. Thank you.

Moderator: Sure. Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Aashin Modi from Equirus Securities. Please go ahead.

Aashin Modi: Congratulations for a great set of numbers. Sir, my first question is regarding volumes. So could you please give us some understanding in the replacement 4% year-on-year growth, which we have talked about in flattish quarter-on-quarter. If you could give segment-wise how replacement market performed and what is the outlook of different segments in the replacement market?

Arnab Banerjee So in replacement market, Q2 is a seasonal quarter, seasonal downturn quarter, as you would know. Y-o-Y truck/bus view at single-digit kind of growth, low single digits. We had a very good growth in farm tyres in replacement market. And 2, 3-wheelers as well as PC/UV grew around mid-single digits by volume in replacement Y-o-Y.

Aashin Modi: Okay. And secondly, sir, on the export side, if you could provide us more color on how Europe and off-highway is performing? And what is the sequential recovery we are seeing over there? And what is the outlook on the export side?

Arnab Banerjee: In export, in Europe, there is some kind of headwind because of slowdown in the economy. We have felt this headwind primarily in the Agri radial which is not growing in Europe. However, on passenger car radial and truck/bus radial, where our base is small, market share wise, but in the context of our volume, the base is pretty big because as I mentioned, about 1 million tyre is the run rate of passenger car tyres in Europe. So in these two segments, we are not really experiencing the headwind because we continue to grow as we keep developing our channel in Europe. Overall, Latin America, there has been some kind of headwind because of duties on TBR tyres, but now the market is adjusting to that new reality, and we expect to come back in the second half of the year in Latin America.

The nearby markets of Africa and Asia are normalizing vis-a-vis last year and would -- are already doing better than last year in the first half and will continue to do well in half 2.

Aashin Modi: Okay. And sir, my last question is, so you mentioned that there has been some changing in pricing during the quarter. Could you please give us more color which segments were they? And any more pricing changes expected going forward?

Arnab Banerjee: In quarter 2, I mentioned there's a relative price positioning change, so I'll explain. In passenger category, there was a straight price increase of 2% roughly in quarter 2. And in truck/bus radial segment, there was a relative price change of 1%, which means there was a downward revision by competition, whereas we didn't revise the price.

So in relative terms, these two categories were most impacted. And there were other changes also in light commercial vehicle tyres to the extent of about 1%. So that was quarter 2. Quarter 3, we will watch the situation, how the raw material moves. And given an opportunity now that our products are very well accepted across categories in terms of being superior by way of tyre life and fuel efficiency, etcetera, we will have opportunities, we'll wait and see what to do.

Moderator: Thank you. The next question is from the line of Raghunandhan NL from Nuvama Research. Please go ahead.

Raghunandhan NL: Congratulations, sir, on stellar numbers and also on the Deming prize. Sir, just wanted to better understand on the pricing situation. On the truck and bus you indicated that competition reduced price by 1%, so just wanted to understand, is it a one-off case where in certain categories, some discounting or price reduction is happening? Or are you concerned about competition intensity increasing in the market?

Arnab Banerjee: Yes. So to clarify, the price reduction by competition is by way of pricing as well as by a way of discounting. Yes, there's a lot of competitive activity happening in the market. But as I mentioned that we have been able to increase volumes in a low seasonal quarter, which is Q2 over Q1. Despite RMC going down, we have changed the relative price standing of our brand in truck/bus radial and PCR. So I wouldn't say we are not concerned but this is an encouraging sign that we have been able -- the market has absorbed this kind of pricing stance by CEAT and has rewarded us with higher volumes. So that's encouraging. But the concern will stay if this continues.

Raghunandhan NL: Understood, sir. And any trends you can provide, sir, in terms of the first few months of the year, how has the market share trend has been? Have you been able to sustain share?

Arnab Banerjee: Yes. So one of the disadvantages of having this call so early in the next quarter is that we don't have the entire data of market share. But I will give you some direction on that. I think we are gaining market share in two-wheeler because the last four months to five months have been really great in terms of motorcycle and scooter sales in replacement market.

And on PCR, I would think that our market share will be steady in the sense that there will not be significant gains or significant losses. And in truck/bus bias we would have gained a little bit of market share and in truck/bus radial, it would be consistent market share. In farm, we would have gained market share in replacement is what we believe.

Raghunandhan NL: Got it, sir. And sir, on the electric vehicle, how would your market share be?

Arnab Banerjee: Electric vehicle, the market shares are relevant for OEMs only because in replacement, the demand is still not anything significant. In two-wheeler, as I mentioned, two-wheeler OEMs, our market share would be 40%-plus. We are there in almost all the leading brands of the country, big and small, traditional players as well as new players such as Ola.

In four-wheelers, I mentioned some of the models where we are working with OEMs closely. And we have a high double-digit kind of market share in four-wheeler OEM. Both these are slated to improve in the next two years.

Raghunandhan NL: Got it, sir. And one of the focus areas was discontinuation of smaller diameter tyres and focus on the larger tyres. Can you update on the efforts because of this, would we be lagging the industry growth? And going forward, do you expect volume growth to be similar to the industry?

Arnab Banerjee: So our exit from smaller rim-size tyre is complete. All that has to be -- that was on the cards has happened. Our Q2 volumes incidentally are -- in OEM are better than Q1 volumes with a better mix of higher rim-size tyres. This volume recovery will continue through Q3 and Q4. And by next year, we will be at a significant growth over a lower base, obviously, because this year, the transformation is happening. And that will be very good for growth in replacement market as well.

Raghunandhan NL: Got it, sir. Just a last question. Can you help us with the segment-wise capacity utilization, two-wheeler, four-wheeler truck and bus?

Arnab Banerjee: So overall, it's improved to nearly about 80%. The outliers here are truck/bus radial where utilization is in excess of 90%. And in farm radial, we have just completed one round of expansion. So optically, the capacity utilization is low, but there's a big demand in US and Latin America, etcetera. So here, the capacity utilization would show as around 65-odd percent, but this is slated to go up in second half and into next year. Otherwise, it's around 80%.

Raghunandhan NL: So two-wheeler, four-wheeler would be around 80%?

Arnab Banerjee: Roughly around 80%. I'm giving you an average figure across categories.

Moderator: Thank you. The next question is from the line of Jinesh Gandhi from Motilal Oswal. Please go ahead.

Jinesh Gandhi: Congratulations on Deming grand prize as the first company on the tyre side. Quickly on the capacity question. So the expansion which we are doing this year, the INR800 crores capex, that is made predominantly towards the OTR tyre, right? Or are we also investing now for TBR?

Arnab Banerjee: Yes, Kumar, would you like to share the breakup?

Kumar Subbiah: Yes. Okay. See, approximately, the revised number of INR800 crores that was communicated includes about INR200 crores of our normal routine capex, which is R&D, IT, digital, moulds and plant-related, maintenance-related capex. So we are talking about balance INR600 crores.

And here, our truck and bus radial, we expect to spend a little over INR100 crores, we expect our OTR to be in the range of about INR250 crores. And we also are spending something on downstream of our Nagpur two-wheeler, passenger car radial two-wheeler. And in addition to that, we also have some small portion of the debottlenecking that we had undertaken in Halol factory. So these things add up to around INR800 crores.

Jinesh Gandhi: Okay. And what kind of capacity addition do we expect from this INR800 crores investment?

Kumar Subbiah: The major upstream capacity expansion is happening at Ambernath, which is specialty. There we are going up from 105 tons per day to 160 tons per day. That plant will be ready in the next year and balance all of them, except some debottlenecking at Halol are mostly downstream capacity, upstream remained constant.

Jinesh Gandhi: Okay. And our strategy of this wide size capex, how long can you sustain them before we get on to a proper brownfield or a greenfield capex? I mean what I'm trying to understand is how long can we sustain this kind of INR800 crores to INR1,000 crores of capex before we have to invest materially in large capacity?

Kumar Subbiah: See, broadly, if you look at our bias tyres capacity, truck, and bus bias we don't expect any requirement in the future. Passenger car and truck and bus radial tyres, both of them we have enough space in our Chennai factory, and therefore, we don't expect any greenfield opportunity in terms of going outside that particular location, as and when we add, we'll add it in the existing locations.

So truck and bus radial is more a brownfield. And in case of two-wheelers, it's more about downstream. So another two years, I don't think we would need any greenfield outside the existing locations. So we don't expect any new greenfield investment required based on our long-term demand and supply plan for FY '25 and FY '26.

And brownfield upstream capacity addition you are aware of, Ambernath is one and then second is truck and bus radial is another one. Other than that, we are not adding any other -- we don't expect to add any upstream capacity in the brownfield for the next two years.

Jinesh Gandhi: Got it. And this TBR INR100 crores is for upstream or that's the downstream?

Kumar Subbiah: Yes. It's a new project, we are adding about 45,000 tyres of capacity per day *(note: please read corrected as 45,000 tyres per month)*. It's an upstream and downstream. It's a brownfield in an existing PCR location at Chennai.

Jinesh Gandhi: Okay. Got it. And in that context, if I look at our debt evolution, so from where we are today at close to INR1,900 crores, we should be easily able to reduce this well below INR1,000 crores by end of next financial year based on our current plan, would that be a fair expectation?

Kumar Subbiah: No. See, we have reduced the debt to the extent of about INR450 crores in the last three quarters. But we don't have a plan to bring it down to INR1,000 crores. We are currently at a healthy level. And our debt-EBITDA is currently hovering around 1.1, 1.2. So this is a very healthy level. And we would like to utilize the cash that we generate beyond capex plan that we have to reduce the debt. So which would be like INR100 crores, INR100 crores is what we have done in the last two quarters.

If the performance sustains and if you maintain the capex level, that is the kind of a direction in which we'd like to move debt to. But we don't have any plans to bring it down to INR1,000 crores. We would like to utilize that cash through productively invest.

Jinesh Gandhi: Fair enough. And lastly, given the expectation of increase in commodity basket by 3 to 4 percentage points. Do you see market being conditioned up to absorb that kind of price increases of, say, over two quarters or so and in turn, maintain our margins above 14%. Is that a likelihood which we're looking at? Or given that you talked about competitive intensity being higher, there could be some risk to margins going forward?

Arnab Banerjee: So Kumar, I'll answer that.

Kumar Subbiah: Yes, Arnab.

Arnab Banerjee: What we are realizing is as the situation is evolving more towards the passenger side where we -- over two-third of our sale is non-truck, there the pricing is increasingly getting detached from the underlying raw material movement, not completely, but it is much more than, let's say, five years back. So there is some pricing freedom there, if I may call so and say so, and it is not so much available on the commercial vehicle side.

So we'll wait and see how the raw material behaves. And 2/3 of our portfolio we have demonstrated that we can take some calls. So we will see if it -- if the market can absorb at least for our brand, we will evaluate it should the RMC play up in quarter 3.

Jinesh Gandhi: Got it. Thanks and all the best.

Moderator: Thank you. The next question is from the line of Siddhartha Bera from Nomura. Please go ahead.

Siddhartha Bera: Hi, sir. Thanks for the opportunity. And congrats, again, on the prize and good set of numbers. Sir, my first question is on this export plan, which you plan to sort of push from the last quarter of this year. Will it be fair to assume, we might see a pickup or an improvement on the exports as early as Q4 of this year, so that it's visible for the entire next year? Or do you think, some of the entry into US, the benefits from that in terms of the revenues might take longer to sort of be visible? So some more thoughts on that.

Arnab Banerjee: Yes. So the entry into US should happen by end of quarter 4 or early quarter 1 next year. So the impact of ramp-up in US will be available throughout FY '25, that's one. Secondly, there was a lot of inventory with the trade and in the smaller and bigger OEMs as well in Europe for Agri radial stocks, which should come down. And though at lower levels, but normal procurement will start by end of quarter 3 or quarter 4. So Europe should also be better even if the market situation doesn't change throughout FY '25 or FY '24. And as I said, Latin America, we are taking some steps to broad base our network there. So that market should as well improve. And some markets in the near vicinity have already normalized to a great extent. So we can expect to see a step-up in exports next year.

Siddhartha Bera: Got it, sir. And one question on the cost side. So if you see the other cost, line items are also steadily inched up even in this quarter despite any sort of major events. And in the current quarter, we have a few events also. So first, some thoughts on why it has inched up? And can we see a bigger jump in the current quarter given that the events are there?

Arnab Banerjee: Yes. Kumar?

Kumar Subbiah: Yes. See, largely, if you look at other expenses, mostly, it consists -- as far as we are concerned, one is our marketing-related expenses; second is the supply chain-related expenses; third is outsourcing related costs; and fourth, broad heads all our operating expenses like travel. If you look at this, there was some drop in marketing costs in quarter 2 versus quarter 1, as we had spent a little more money in quarter 1 on IPL and related marketing costs. Where it went up in quarter 2 versus quarter 1 were broadly in three different areas. Our quantum of outsourcing volume in quarter 2 was higher than quarter 1, particularly in two-wheeler tyres. And number two is, we moved the tyres from a factory location to the distribution location, we had incurred our SVC cost. It wouldn't have a profit and loss impact, but on a line item wise, it will show other expenses, but it is normally part of the closing inventory. Third, our travel costs were a little higher. Our conferences happened in quarter 2. People started traveling more. So we had incurred little higher level of travel cost.

Coming to your question, whether we'll see a higher level of other expenses in quarter 3 and quarter 4. I think other expenses will go up in the event activity increase. If there is a quantum jump in volume in quarter 3 versus quarter 2 or quarter 4. However, otherwise, it should not go up from this level of base into quarter 3 and quarter 4.

Siddhartha Bera: Got it, sir. Sir, lastly, on the working capital also in the -- as we started the year, you had told about that, it might go up in the year, and we don't expect any sort of decline there. But in the first half, we have managed quite well. So do you think in the second half given the demand, how it is -- the working capital levels can still go up or we believe it may continue to remain where they are?

Kumar Subbiah: See, we continue to exercise tight control in quarter 1, quarter 2. Normally, quarter 4 is when our working capital would be at its best because of higher level of sales in quarter 4. And our debtors come down, we end up normally with a little lower level of inventory. We maintain that discipline coming into quarter 1 and quarter 2, both on our raw materials and finished goods. So that really helped, it is lower than what we had originally envisaged, keeping in mind the service levels. Our endeavour is to maintain at this level, and in the event that we want to improve our service level or if you see some delay in the transit of materials, particularly in the case of international business, we may have a little higher level of inventory. Otherwise, our endeavour is to keep it closer to our current levels.

Siddhartha Bera: Got it, sir. Thanks again. I will come again in the queue.

Moderator: Thank you. The next question is from the line of Chirag Shah from White Pine. Please go ahead.

Chirag Shah: Yes. Thanks for the opportunity. Sir, first question is -- actually, I was disconnected in between, so apologies for repetition. So volume growth for the quarter?

Arnab Banerjee: Yes. Volume growth Y-o-Y is about 7%.

Chirag Shah: And sir, this is in standalone or this is including the Sri Lanka at consolidated level?

Arnab Banerjee: Yes, it is stand-alone.

Chirag Shah: Standalone. Okay. And sir, second question is just a clarification on this OTR side. So you explained, what's happening on the US, how we are looking at it. But if you look at '25 and maybe '26, how should one look at the geography mix for the OTR between -- on the export side?

Arnab Banerjee: Can you please repeat your question?

Chirag Shah: Sir, on the OTR, if you take '26 as a year, how one should look at the geography mix between, say, Europe and US? How do you envisage that playing out for you? '25 being the year of feeding the US market, that's why -- so how should one look at the mix between US and Europe for your OTR business?

Arnab Banerjee: Yes. So OTR and Agri radial business, we are already in the US market. When I said, we'll launch in the US, it is passenger radial and truck/bus radial. In US, we have already started growing, creating the network. We have a team of local team there in the US already. We have started getting to the OEMs. But in Europe, we are ahead of US. So we have to see, how these two geographies behave. We are quite bullish on US market as well.

Chirag Shah: Okay. But is it possible -- so internally, are you looking at kind of an equal split between the two geographies or one geography could have a higher share for next two years, three years?

Arnab Banerjee: Both are very big markets in their own ways. The product ranges are different. We are catching up on the product range on the US side because we entered that market later. But both will be equally big. I mean not exactly equal, but both will be of equal dimensions going forward.

Chirag Shah: Okay. Thank you and all the best.

Moderator: Thank you. The next question is from the line of Disha Sheth from Anvil Shares & Stock. Please go ahead.

Disha Sheth: Sir, good afternoon. Sir, you mentioned that OEM demand has been varied in Q3. So can you -- if you can just throw a light on segment-wise? As you said, replacement is stable over Q2 in terms of outlook. Hello?

Arnab Banerjee: Yes. So I mentioned about OEM demand in Q2 actually. Yes, it was varied. So just to give you some description category-wise, two-wheeler, the OEM demand was flat to slight de-growth. The OEM volumes grew only in the month of September, and still they are far, far below the FY '19 peak pre-COVID, so that's two-wheeler.

Four-wheeler is doing well, growing well. They have topped an all-time high of 2 million tyres in half 1, and this industry is slated to cross 4 million cars in that entire year. So that's doing very well. The truck segment dipped very unexpectedly in the month of June, but it has recovered in quarter 2, and it is growing at single digit. So that's the kind of lay of the land in OEM in Q2.

Disha Sheth: Yes, sorry. So the outlook remains on the similar lines for Q3 and the year in terms of your order book?

Arnab Banerjee: See, Q3 is usually people are -- OEMs are very optimistic because of the festive demand in October and November. So retail offtakes are reported to be good in the month of September. We also track their retail offtakes. We have to see how that production comes up because that's what decides our demand. So optimistic in the first two months, but then December is a winter month where, again, demand slows down, and it picks up again by Feb and March. So it's a cyclical seasonal thing. Q3 may be good if the festival thing works out well and if the monsoon effect is good.

Disha Sheth: And sir, in Europe in terms of off roader, the demand is still bleak or there are signs of improvement?

Arnab Banerjee: No, the trade and the OEM destocking is -- has still happened over Q2. We expect the demand to improve by end of Q3 and Q4. That's the current expectation.

Disha Sheth: Okay sir. Thank you so much, sir. That's it from my side.

Moderator: Thank you. The next question is from the line of Rishi Vora from Kotak Securities. Please go ahead.

Rishi Vora: Thank you, sir for giving the opportunity and congratulations on good set of numbers. Just one thing on the natural rubber procurement, can you just give us a sense on how much of the natural rubber requirement is met through domestic market? And how much is imported? And also, lately, we have seen that international price -- rubber prices have surged quite significantly. So what is the reason behind it? And do you expect that domestic natural rubber prices because of the higher international rubber prices can inch-up? Like how has been the historical trend of the commodities, that would be helpful?

Arnab Banerjee: Yes. Kumar?

Kumar Subbiah: Yes. See, there are broadly two grades of rubber that go into tyres. One is called a block rubber and another one is called us sheet rubber. Indian production is largely sheet rubber. Almost 95% plus is sheet rubber, and that is what we buy from the local market. And almost all of our sheet rubber we buy locally. And block rubber is what we import from the international markets. So our overall -- if you look at the split between block rubber and sheet rubber, okay, approximately 60% of our rubber would be block and 40% of that would be sheet. So that's normally the average distribution between block and sheet.

You are right, the international prices have moved up in the last two to three months. And in the previous three months, actually, international prices were lower than the local market. So therefore, there's always been a commodity, an arbitrage between the two sources of similar kind of materials. There are three possibilities. One is that the natural rubber prices move towards international prices or international prices come down and natural prices move up and they strike a balance. Or there's always a difference of about INR2, INR3 per kg between two sources of rubbers. So being a consumer of natural rubber, we would prefer international prices to come down rather than expecting local prices to go up. So only time will tell. There are no strong fundamental reasons for the international rubber to go up, except the fact that sometimes there's a sympathy towards crude oil prices, and therefore, it has a rub-off effect on block rubber. And last, is the reason for international prices to be higher than local rubber is also because of the fact that currency, Indian rupee, which was around INR81 to $1 is now on INR83.20, INR83.50. That itself has had about 3%, 3.5% kind of an impact. So it's possible that could be a midpoint between local and international rubber and that's the way the market could unfold. And that midpoint could be local rubber going up, if international prices remain to -- remain at the same level.

Rishi Vora: Understood. And sir, what would be the difference between the current landed cost of international rubber and the domestic rubber prices today? Like any sense you have?

Kumar Subbiah: See, look, you know it's a commodity. There's no one fixed price. But however, I'll give you a broad range. International could be around INR157, INR158 landed and local could be INR150, INR151 landed, something like that.

Rishi Vora: Understood, sir. And just lastly, on this -- on the volume growth and the revenue growth. So on a Y-o-Y basis, I know you indicated the volume growth is 7% and revenue growth is a little bit lower. So there has been an ASP decline. And my understanding was that over the last one year, we would have taken price increases. So what is the reason behind ASP decline on a Y-o-Y basis? Is it just a mix or is there any other reason?

Kumar Subbiah: Arnab, you want me to take?

Arnab Banerjee: Yes, you can.

Kumar Subbiah: Yes. Okay. I'll take part of it, maybe Arnab will be able to substantiate even more. As was explained, the realization from our -- one of the three segments, which is original equipment manufacturers is linked to the movement in the raw material prices. So in a scenario where if raw material prices come down, our realization also comes down with the lag of three months and the reverse is also true. So that's one of the main contributors for a little bit of a higher level of volume growth on the total value growth and maybe a marginal decline in the price growth at the company level. Yes, because of the OEM mix impact on the total realization.

Rishi Vora: Understood, understood. Thank you and all the best.

Moderator: Thank you. The next question is from the line of Akshay Karwa from Anand Rathi.

Akshay Karwa: Hi, sir. Good evening and thank you so much for the opportunity. Just one question on the margin side. Sir, now that we have stopped manufacturing those smaller rim tyres and we will be focusing on the larger tyres, how do we see the margins going forward in the next two years by '26? I mean this quarter; we did a 14.9% adjusted EBITDA margin. So where do you see that trend shaping up, sir?

Arnab Banerjee: Yes. So when I said we are exiting small rim size to higher rim size, it is for passenger segment and in OEMs. So in the OEM segment, as it is the margin is low across rim sizes, the impact will come from higher replacement demand of higher rim sizes, where the margins are definitely high. And the impact of passenger, the saliency of passenger car tyre in our overall business is let's say, around 20% or so. So the impact will take time to come. It will come gradually, but it will be positive as things now stand. Now, the higher rim size margins are significantly superior to the smaller rim size margins.

Akshay Karwa: So I mean can we -- like in order to model, so can we assume that something like 17% margins going forward, like in the next -- after like two, three years or something like that? Or...

Arnab Banerjee: Yes, yes, it will take at least two years to translate into significant improvements.

Akshay Karwa: Got it, sir. That's all from my side, sir. Wish you all the best.

Moderator: Thank you. The next question is from the line of Vishal from Svan Investments. Please go ahead.

Vishal: Thank you for taking my question. Sir I had two questions. First, regarding, sir, in terms of RM prices, what possible action you would be taking to reduce the impact of our RM increase which is happening right now through product mix or geography mix or channel mix?

Arnab Banerjee: Yes. So as the RM price creeks up, we are already seeing -- over the last two years, we are focusing on the non-truck side, which is two, three-wheeler, four-wheelers, and off-highway tyres. So the saliency of this is going up and it will continue to go up quarter-on-quarter as we speak. So that is one. Plus, there are some micromanagements of product market mix, which we'll also be focusing on. The last resort and definitely a good option also if there's a significant rise in RMC, we'll look at pricing because as I mentioned a while earlier, on the passenger side, there's a little bit more pricing freedom than the commercial side. So we'll look at that as well to mitigate the RMC hike, which looks like inevitable. That's going to happen.

Vishal: Okay. Okay. Sir, my next question is regarding what kind of peak revenue you can get from the current capacity which you have?

Arnab Banerjee: Yes, Kumar, would you like to comment on that?

Kumar Subbiah: We had shared this in the earlier calls. Based on 31st March situation, based on the assets that we had commissioned without taking into consideration this truck and bus radial addition and OTR Ambernath addition, I think our revenue potential is a little in excess of INR14,000 crores. So that was a kind of a headroom without taking into consideration what we are adding this year and next year. So that is the level after which we can go.

Vishal: Okay. So suppose that in FY'25 and '26, the kind of capacity expansion we are taking, you shared the debottlenecking plan, so what kind of peak revenue you can generate from -- once those capacities come in line?

Kumar Subbiah: See, we are adding about -- this year -- last year, we added about INR900 crores of capex, okay, only to the extent of assets commissioned, we've taken into consideration and we said the commissioned assets would give us a revenue potential of INR14,000 crores. Approximately, without going into specific details, depending on how we commission assets, whatever we are going to add this year, what we added last year but not commissioned and what we are going to add next year another INR2,000 crores kind of a plus kind of a revenue opportunity is there by FY'26 plus INR2,000 crores plus kind of an opportunity, should we use all the assets to a 90%-plus kind of a capacity utilization.

Vishal: Great, sir. Great. Great. Sir, one small question regarding the OTR ramp-up, you said that 160 tons will be completed by FY'24 end?

Kumar Subbiah: Yes, it will be in quarter one or quarter two of next financial year. It is likely to be there at that time.

Vishal: Okay. Sir, post that in FY'25 and '26, what kind of expansion we are planning for this segment?

Kumar Subbiah: Arnab, would you like to respond?

Arnab Banerjee: Yes. So right now, we are at 105 tons, which is completed, which we intend to ramp up and fill by quarter one of next financial year. In the meantime, 105 itself is getting expanded to 160. So we are evaluating at what point of time we will run it up to 85%, 90% capacity and then take up the next expansion. So we are waiting and evaluating at this point of time, 160 is visible.

Vishal: Okay. Okay. Sir, how much the gross margin improvement happened in Q2 was because of this mix improvement maybe in product, geography, or channel?

Arnab Banerjee: Yes. So the overall improvement is 2.2% roughly. About half of that would have come from product market fit improvement.

Vishal: Okay. Sir, my last question regarding what kind of internally you are targeting ROC improvement by next two years, FY'25 and '26?

Arnab Banerjee: Yes. Kumar?

Kumar Subbiah: I think we had broadly explained our logic. Our endeavour is to be somewhere in the range of 14% to 16% kind of ROC. Eventually when we cut down our investments, when we commissioned all of the assets, I mean the commodity environment is stable, that's the kind of a range at which we would like to reach. Most of our new investments that we have made in the last three years or so, and we had a visibility to that. For example, we always looked at capital investments or capex, which gave us a payback of five, six years and that translated to this kind of ROC. So that is the direction in which we are moving. I think we are not looking at destination as of now, we are looking at many milestones at which we would like to cross in this journey and then keep moving towards that particular direction.

Vishal: Fantastic, sir. Thank you. Thank you and all the best, sir.

Moderator: Thank you very much. We'll take that as the last question. I would now like to hand the conference back to the management team for closing comments.

Arnab Banerjee: So thank you very much, and I wish you all the best for the festivities coming up in quarter three and see you next quarter. Thank you.

Moderator: Thank you very much. On behalf of DAM Capital Advisors Limited, that concludes this conference. Thank you for joining us. Ladies and gentlemen, you may now disconnect your lines.